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ABSTRACT

One of a series, this booklet on world issues explains why Brazil has become important for the United States. Brazil's rise from a sleeping giant to continental leader is investigated. Brazil's impressive economic growth from the mid-1960s through the 1970s is explored. An analysis of Brazil's economic crisis of the 1980s is also explained. Brazil's recent restoration of civilian government after a generation of military rule is highlighted as well as the choices facing Brazil's new leaders. The document concludes by examining the options for U.S. foreign policy toward Brazil. Critical questions, such as how the United States will respond to Brazil's current growing pains and what major impacts will Brazil have on the Western Hemisphere, including the United States, are investigated. Also included is a "Talking It Over" section which offers discussion questions for individuals and groups and a suggested reading list. (RSL)

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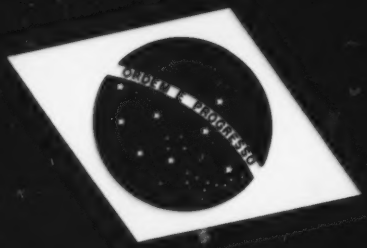
FOREIGN POLICY ASSOCIATION
HEADLINE SERIES

# BRAZIL AND THE UNITED STATES

by Abraham F. Lowenthal



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**Headline Series**

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# BRAZIL AND THE UNITED STATES

**by Abraham F. Lowenthal**

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# Preface

This is the first HEADLINE SERIES devoted entirely to Brazil. Recent issues have included studies on Mexico, the Caribbean, Central America and Puerto Rico—but none on the largest and most powerful nation in Latin America.

Brazil has not been the focus of attention because U.S. relations with Brazil have never been particularly complicated. Despite its vast size, Brazil traditionally has been viewed from Washington as a distant country with which the United States has few problems.

From the turn of the century on, both U.S. and Brazilian officials have periodically proclaimed a "special relationship" between the two countries. But the quality of that relationship, like that between relatives residing at a great distance from each other, has not often been tested. President Richard M. Nixon once proclaimed that "as Brazil goes, so will go the rest of the

*This publication was made possible in part by a grant from the Ford Motor Company Fund.*

Latin American continent," but no sooner had he exaggerated Brazil's significance than Washington promptly ignored Brazil once again.

The United States can no longer afford to take Brazil for granted. Major economic and political changes during the past generation make Brazil a country to be reckoned with. Transformations within Brazil and in the international environment have greatly increased the stake of the United States in Brazil's prosperity and stability.

This HEADLINE SERIES explains why Brazil has become important for the United States. It traces Brazil's rise from a perennially sleepy giant to a continental leader. It explains Brazil's impressive economic growth from the mid-1960s through the 1970s and analyzes Brazil's economic crisis of the 1980s. It highlights Brazil's recent restoration of civilian government after a generation of military rule and discusses the choices facing Brazil's new leaders.

Finally, the options for U.S. policy toward Brazil are examined. How the United States responds to Brazil's current growing pains will significantly affect Brazil. Equally important, how Brazil fares will ultimately have a major impact upon the whole hemisphere, including the United States.

This HEADLINE SERIES is based on a book in progress on U.S.-Latin American relations. Support for the book project has been provided by a number of sources, including the Twentieth Century Fund, the Woodrow Wilson International Center for Scholars, the University of Southern California, and CEBRAP in São Paulo, Brazil.

For invaluable assistance in helping me adapt a chapter of my book, I am indebted to Linda Lowenthal of Oberlin College. She is no less strict an editor for being my daughter.

# 1

## A Nation to Be Reckoned With

Brazil's sheer geographic area, its huge population and its abundance of resources have endowed it with great potential as a world power.

Brazil is, by area, the fifth largest nation in the world; it is larger than the United States excluding Alaska. It shares borders with 10 other nations; only the Soviet Union has more neighbors. Brazil is the sixth most populous country in the world, with a population approximately equal to that of Mexico, Argentina, Chile and Venezuela added together. Brazil's economy has become by far the largest in Latin America, the biggest in the entire Third World except for China, and the ninth in the world (the seventh among market economies). Its gross domestic product (GDP)—some $235 billion in 1985—exceeds that of all other South and Central American countries combined.

Brazil's resources are legion. The country's reserves of iron ore are either the world's largest or second largest. Brazil ranks first in hydroelectric potential; its total electric-generating capacity is already tenth in the world and doubles every eight years. Its utilized, underutilized and unused lands are vast. Brazil has one



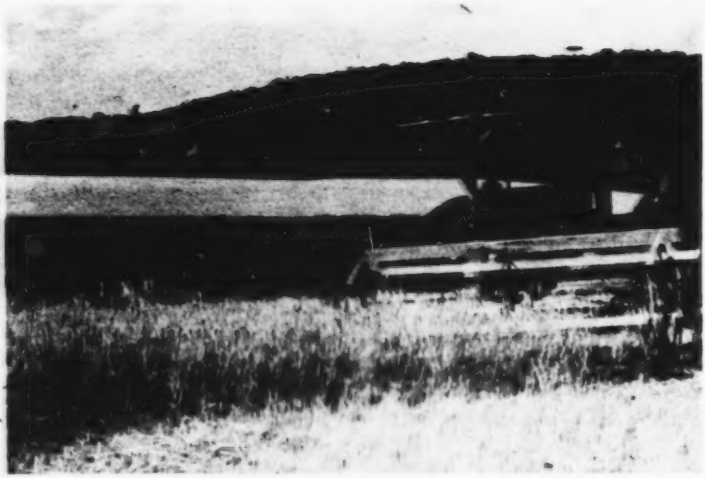
8

of the world's few remaining habitable frontiers. Mineral riches—uranium, bauxite, manganese, copper, iron and, most recently, gold—are still being discovered (or rediscovered, in the case of gold). Of the resources needed for modern industry, only petroleum has been missing in Brazil in significant quantities, and important deposits have been discovered in recent years.

Brazil is already a major actor in the international economy. It exports more agricultural commodities than any country except the United States. In coffee it ranks first; in soybeans and cocoa, second; and in tobacco, fourth. Brazil is the world's largest exporter of iron ore. It is, next to South Korea, the largest industrial exporter among developing countries, and is the developing world's second largest steel producer. In 1980, Brazil produced 26 percent more steel than Britain. As a producer of automobiles, it ranks with Spain and close to Canada and Britain.

Brazil is also among the world's major exporters of weapons. It sells aircraft, tanks, missiles, armored personnel carriers and similar items worth well over $1 billion a year to more than 30 countries. Brazilian-made airplanes fly many commuter-line routes in the United States and are used in over 20 other nations. Brazilian-built ships sail in many parts of the world. Brazilian-manufactured engines run many U.S.-built cars. Brazilian computers are used in China. Brazilian engineers and contractors have been undertaking major construction projects elsewhere in Latin America, the Middle East and Africa.

Brazil is a significant force in various other aspects of international affairs. As the developing world's largest debtor (with some $100 billion in outstanding loans), Brazil obviously affects the global financial system. As one of the Third World's main exporters and importers, Brazil is important in international commerce. As one of the nations most seriously committed to seeking alternatives to fossil fuels, Brazil influences world energy supply prospects, as well as the climate for nuclear nonproliferation efforts. Brazil also affects international negotiations on matters ranging from coffee and sugar to the Law of the Sea and the future of southern Africa, as well as international energy,



Courtesy Brazilian Government Trade Bureau

**Brazil strives to become self-sufficient in wheat, one of the few foodstuffs it has to import.**

finance and trade. Although Brazil has not traditionally sought a visible leadership role in international forums, its influence has steadily grown.

Brazil's scope eclipses that of any other Latin American nation. Brazil accounts for almost 35 percent of all of Latin America's gross output of goods and services, foreign investment, and trade in manufactured goods. Brazil's cultural activities project the country's image abroad; some 15,000 Latin American, African and other foreign students have come to Brazil in recent years on official programs. No other nation in South America approaches Brazil's degree of industrial development, the extent of its international involvement, or the strength of its military establishment (although the size and budget of the armed forces are low in per capita terms). Brazil's large, professionally skilled diplomatic corps is prominent at the United Nations, the Organization of American States and elsewhere.

Brazilians have long seen their country as an emerging world power, endowed with a kind of "manifest destiny." Brazil's

leaders (and many Brazilians of all levels and sectors) expect their country to be taken seriously, to be consulted and even courted internationally. They want to ensure that Brazil's interests will be taken into account, that the established world powers will not freeze Brazil and other emerging countries out of a chance for more power, prosperity and status. They have become increasingly frustrated at what they see as external constraints on Brazil's prospects for growth.

### *The Sleeping Giant Awakens*

Until a generation ago, it was a wry commonplace that "Brazil is the country of the future—and always will be." The country's sheer size inevitably gave it some international significance even then. But Brazil was not really powerful, and its foreign policy aspirations could usually be met by essentially symbolic gestures.

Until the 1960s, Brazil had never managed to harness its material and human resources effectively. During the late 19th century and for the first several decades of the 20th, neighboring Argentina—although a considerably smaller country in area and population—consistently outranked Brazil on most indicators. By 1960, Brazil had caught up with and even surpassed Argentina, but this was due at least as much to Argentina's postwar decline as to Brazil's progress. Brazil was still a sleeping giant.

All that has been changing in the past generation. Few nations have grown so much, so quickly and on such a grand scale as has Brazil in the last 25 years. Even with its current problems, Brazil is a nation to be reckoned with.

Brazil has been altered, first, by the explosion of the country's population from about 70 million in 1960 to over 135 million today. Although the rate of population growth in Brazil has begun to fall, by the end of the century its population should reach 180 to 200 million, equal to that of the United States in the 1960s, and it may reach 300 million by the second half of the 21st century. Four out of ten Brazilians are under age 15, so that Brazil's work force continues to expand enormously.

Brazil has also been reshaped by urbanization. Although major traditional rural enclaves still remain, the modern and urban

nation within Brazil has grown apace. The urban share of Brazil's population spurted from 32 percent in 1950 to over 70 percent in the 1980s, the level found in several advanced industrial societies. Between 1970 and 1980, the rural population decreased in absolute numbers for the first time in Brazil's history. São Paulo, a city of restless dynamism, has an estimated population of 14 million; eight other cities now have populations over 1 million, compared with two just 25 years ago.

Brazil's increasingly urban population has entered the modern era. The number of Brazilians with electricity, sewage facilities and potable water in their homes has nearly doubled in a generation—although many still lack these amenities. The number of radios, televisions, telephones and telexes has exploded.

Education, a major contributor to modernization, has boomed. Adult literacy jumped from just over 40 percent in 1948 to about 60 percent in 1960 and to well over 70 percent (almost 80 percent by some estimates) in the 1980s. The number of Brazilian youths in secondary schools multiplied almost ninefold between 1960 and the late 1970s, to over 2.5 million. University enrollment is now well over a million.

These social and demographic changes have contributed to a fundamental transformation of Brazil's politics. Almost 59 million people went to the polls in November 1982 in the gubernatorial and congressional elections, almost four times as many as had participated in the legislative elections of 1962. Major sectors of Brazilian society—industrial workers, shantytown dwellers, women and lay participants in local religious movements, as well as business executives and professionals—have immersed themselves in electoral politics. Professional associations, labor unions, neighborhood organizations and political parties—although they are all still weak—have gained institutional strength in recent years, even during the prolonged period of authoritarian military rule.

The Brazilian state has also been transformed. Brazil's public sector (including state-controlled enterprises) now accounts for well over half of the national economy; some 46 percent of the country's financial resources are under the direct control of the

federal government. More than 500 Brazilian firms, including 9 of the 10 largest, are state-controlled. The dramatic growth of Brazil's public sector has increased the state's capacity to plan, tax, invest and control—if also to waste. A new and powerful technocratic class has built a dense network of relations between private business and the public bureaucracy.

***Rapid Industrialization***

In the 1950s, Brazil's economy was still largely organized around coffee: 56 percent of Brazil's export earnings in 1960 derived from that crop, which shaped the country's international concerns. By the 1980s, however, coffee contributed less than 10 percent of Brazil's export earnings. Agricultural diversification accounts for some of this dramatic difference, to be sure. Brazil has captured the largest share of the world trade in frozen orange juice concentrate. It has also become a major exporter of frozen poultry and soybeans, competing successfully with the United States for markets.

The most striking shift in Brazil's economy has been its rapid and pervasive industrialization, based mainly on import substitution (producing goods it formerly had to import) in the 1940s and 1950s, then also on export promotion since the late 1960s. The share of Brazil's work force employed in agriculture has declined by one half within one generation (to about 30 percent), while the industrial work force now comprises almost 20 percent of the economically active population. Industry now accounts for almost 35 percent of Brazil's GDP.

Within one generation, Brazil transformed itself from an importer to an exporter of steel, heavy machinery, petrochemicals, weapons and other industrial products. For example, Brazil imported 4.3 million tons of steel in 1974; 10 years later it exported over 4 million tons. The share of Brazil's exports accounted for by manufactured goods exploded, incredibly, from 3 percent in 1960 to over 65 percent in 1985. As if to symbolize the country's newly assumed economic role, Brazil's exports of automobiles and auto parts in 1981 exceeded in value its exports of coffee.

Courtesy Brazilian Consulate General, New York City

**Shipbuilding: one of Brazil's leading industries**

### *A Global Economic Power*

As Brazil's economic structure has evolved, its involvement in the world economy has become much more complex. Exports grew an average of almost 10 percent annually in real terms from 1965 to 1980. Brazil's imports, meanwhile, climbed about as fast as exports, as the country came to depend increasingly not only on imported petroleum but on many capital goods. Foreign investment in Brazil rose sharply to over $23 billion, the highest level in the developing world, although it has leveled off in recent years. Most important, Brazil's foreign debt surged from a negligible $2 billion in 1960 and a modest $21 billion in 1975 to its present massive size. Annual debt-service charges jumped from 33 percent of exports in 1974 to over 80 percent by 1982, with interest payments alone at over 55 percent. Although they had dropped to below 40 percent by 1986, this is still high by historic standards. Brazil is paying out some 4 percent of its GDP each year to service the debt; this drain is not long sustainable, economically or politically.

During the 1960s and 1970s, Brazil significantly diversified its markets and its sources of capital and other imports. The share of Brazil's exports bound for the United States declined steadily from 1960 to 1980; the proportion going to Western Europe and to Japan significantly increased. Brazil's exports to other Latin American countries more than doubled, and trade with African countries, Asian countries other than Japan, and with Eastern Europe also increased steadily in the late 1970s, albeit from a much lower base. Brazil's commerce with the Soviet Union expanded as well.

Although U.S. investment in Brazil has climbed in absolute terms, the U.S. share of overall foreign investment in Brazil declined from about 45 percent in 1960 to about 30 percent in the 1980s. This was largely a result of rapidly increasing European and Japanese investment and some investment from the Arab Middle East. Brazil also significantly diversified its debts; the share of Brazil's debt owed to European banks increased from 27 percent in 1971 to 44 percent in 1980. As in most other Latin American countries, official U.S. aid came to represent a tiny share of Brazil's external financing, while commercial bank lending rapidly increased.

Brazil in the 1980s has suffered severe economic problems, discussed more fully in Chapter 3. One immediate result of these difficulties has been to halt or even reverse temporarily Brazil's long-term trend toward diversifying its trade, debts and sources of investment. Brazil's export revenues declined substantially in 1982 because many industrial countries, as well as most of Brazil's new trading partners in Latin America and elsewhere in the Third World, could not keep up their imports. Major reductions, over 40 percent in each case, occurred during 1982 and 1983 in Brazil's exports to Argentina, Chile, Mexico, Uruguay, Poland and Algeria; Brazil's exports to all Latin American non-oil exporters in 1983 were 49 percent of their 1981 level. The share of Brazil's trade accounted for by the United States consequently shot back up; in 1984 and 1985, the United States accounted for about one third of Brazil's exports. This expansion is likely to be temporary, however, a result of the

overvalued dollar and the slump of Brazil's other trading partners.

Brazil's broadening of its international links during the 1970s increased the country's autonomy but it remains vulnerable to world economic conditions. Brazil's prosperity depends more than ever on trade and especially on external capital. As interest rates change, for instance, Brazil's economy is powerfully affected; a 1 percent adjustment in the London Interbank Offered Rate (LIBOR), a standard base for international lending, means $700-800 million in Brazil's external payments for a year.

Brazil is still quite vulnerable to international economic reverses but it also has more power to affect the world economy. If Brazil's economic recovery in the mid-1980s can be sustained, this could significantly expand the market for exports from the United States and other advanced industrial nations. A return by Brazil to a prolonged and severe depression, on the other hand, could harm the chances for economic recovery in several major industrial countries, because of both the contracted Brazilian market and the impact on international commercial banks.

A default by Brazil on its debt or an extended moratorium would have serious repercussions for several major U.S. banks; the nine largest U.S. money-center (as distinct from regional) banks have some 39 percent of their capital on loan in Brazil. Even a one-year delay by Brazil on payment of the interest due on its foreign debt could significantly reduce the profits of those banks. A major setback for these U.S. banks, in turn, could adversely affect the banking system of the United States and international finance more generally.

Because of its generation-long export-led growth, the diversification of its international ties, its severe debt and trade problems in the early 1980s, and its incipient recovery in the past two years, Brazil is an important part of the world economy. An effective U.S. policy toward Latin America needs to take fully into account Brazil's new economic significance as well as its difficulties.

# 2

# From Sleeping Giant to Continental Leader: Brazil to 1964

Brazil's evolution into a dynamic, increasingly powerful nation has been slow and uneven.

Until the 1930s, Brazil was an overwhelmingly rural society. Its internal economic and social structure was based essentially on a peasant-landlord relationship. Its position in the world economy was that of an exporter of a few primary crops. The rural nature of the society encouraged a stable, elitist political culture. The landed aristocracy—plantation owners, ranchers, coffee entrepreneurs—cooperated with the military, the church and the state bureaucracy to dominate the government, compromising among themselves and incorporating newly emerging groups to head off potential conflict. The resulting system was pragmatic and flexible. It was characterized, as well, by a striking absence of mass political mobilization. The dominance and solidarity of the elite, together with the rural population's isolation, made popular participation an unimportant factor in Brazilian politics.

Many historians date Brazil's emergence into the modern era from the regime of Getúlio Vargas, who came to power in 1930. Vargas was not, of course, solely responsible for initiating Brazil's

transformation. The onset of global economic depression devastated the world coffee market, making it impossible to maintain Brazil's traditional economy. The depression also weakened the Republican regime, paving the way for the bloodless coup that brought Vargas to power. Finally, the Vargas regime incorporated many ideas and demands of the Brazilian intellectuals of the 1920s who had advocated modernization and nationalism. Uneasiness and dissatisfaction had been growing for some time.

Vargas himself, however, was a powerful force for modernization. An energetic, charismatic leader, Vargas assumed office with a will to modernize. He overhauled the bureaucracy, took steps to limit the powerful forces of regionalism, and in 1934 drew up a new constitution. Although similar in many ways to that of 1891, this constitution extended the vote to women, made provisions for social welfare legislation and featured other liberal reforms. Vargas fulfilled many of his promises by enacting laws for a minimum wage, an eight-hour workday, public education and health programs, and other benefits. Unlike any Brazilian leader before him, he made an effort to appeal to the poor and to the middle class.

***Dictatorship and Economic Recovery***

Vargas' efforts were rewarded with mass support, but he did encounter political opposition. He defeated a counterrevolutionary attempt in 1932, only to face more-intense unrest involving both Communist and Fascist groups. As violence mounted, Vargas declared a state of siege. When in 1937 it appeared as if the leader of the Fascist Integralist party might win the upcoming presidential election, Vargas wrote a new, far less liberal constitution and cancelled the election. So began the *Estado Novo* period, during which Vargas ruled as a dictator.

Under the Estado Novo, Vargas forged ahead with ambitious projects for social and economic reform. Although he curtailed civil liberties and outlawed strikes, he continued to expand the social welfare system and instituted a labor code that gave unions and urban workers many benefits. Vargas turned his energies increasingly to industrialization. Because the economic crisis of

the 1930s had reversed Brazil's balance of trade, import substitution became the centerpiece of Vargas' program. He introduced tariffs, government regulation of the economy, and large-scale projects to develop hydroelectric and other forms of energy. As a result, light industries (foodstuffs, textiles, and the like) expanded dramatically. The culmination of Vargas' efforts was the construction of the Volta Redonda steel plant, completed with U.S. aid, which established Brazil's steel industry.

Brazil under Vargas achieved a fairly promising recovery from the depression. Modernization and reform made great strides, as did economic nationalism and self-sufficiency. World War II brought new, though temporary, troubles. The war disrupted world trade, making it difficult for Brazil to sell its export products while also restricting access to needed imports. This new crisis revealed the limits of the previous decade's progress. Industrialization involved only a small segment of the still-fragmented nation, and Brazil was not wholly self-sufficient in any major industry. Yet the war ultimately accelerated Brazil's modernization by bringing the country, after a brief flirtation with economic cooperation with Germany, into a closer alliance with the United States. In exchange for supplying resources, military aid and support to the allies, Brazil received substantial U.S. aid which set the stage for further industrial growth.

The period after World War II was one of economic acceleration and democratic reform. In the postwar atmosphere, the Vargas dictatorship seemed increasingly oppressive to many Brazilians. As restlessness and dissatisfaction mounted, Vargas relaxed many restrictions and scheduled free, competitive elections for December 1945. However, as the campaign progressed, the military grew suspicious that Vargas was planning another coup. On October 29, 1945, officers demanded his resignation. When Vargas refused, they deposed him.

### *Second Republic*

The ousting of Vargas initiated Brazil's second republic, a period of relatively free political activity which lasted until the military takeover of 1964. Although the personalities of key

leaders continued to dominate politics, a multiparty system provided a substantial degree of pluralism. Before his removal, Vargas had promoted the formation of two political parties: the Social Democratic party (PSD) and the Brazilian Labor party (PTB). These became two of Brazil's major political parties, while the National Democratic Union (UDN) emerged as the leading opposition party, and many smaller political organizations, ranging from the extreme right to the extreme left, sprang up. Presidential elections—probably the most honest Brazil had ever had—were held as scheduled in 1945, and Vargas' former minister of war, General Eurico Dutra, became president. Vargas, to the surprise of some, became a senator.

Dutra and the new government were serious about political reform. Congress drew up a new constitution in 1946, formulated with an eye toward preventing another dictatorship. Similar to the 1934 constitution, it protected civil liberties, extended the vote to all literate persons except soldiers on active duty, and provided for five-year presidential terms with no reelection. Freedom was curtailed somewhat when Dutra outlawed the Communist party and imposed a number of additional restrictions on the political left.

Dutra's economic policy, like his anticommunism, was influenced by the postwar atmosphere. The wartime restrictions on imports had allowed Brazil to amass large foreign exchange credits. In addition, other nations' postwar recoveries expanded the market for Brazilian exports. Confident that the opportunity for further growth had arrived, Brazil turned away from economic nationalism and removed restrictions on foreign trade and investment.

This policy, however, proved disappointing. Brazil's reserve of foreign exchange credits was rapidly exhausted, spent mainly on luxury items rather than machinery and capital investment. Overvaluation of the currency induced Brazilians to spend more on imports but made Brazilian exports less attractive to other nations. Budget deficits and foreign debt were allowed to grow. Although Brazil's economy never collapsed, it was continually plagued by inflation and waste.

***Vargas' Return: 1950–54***

These economic problems proved difficult to solve. Criticizing Dutra's retreat from nationalism, Vargas successfully ran for the presidency in 1950. He made the economy his top priority and adopted nationalist rhetoric, strongly disparaging foreign investment. State participation in the economy increased; moreover, the state was not involved merely in regulation but in actual business activity. A prime example was Petrobras, the mixed public-private capital corporation he created to monopolize the Brazilian oil industry. Import-substitution industry continued to expand, building on the foundation laid earlier; heavy industry, in particular, made large gains in relation to food and textiles.

But inflation continued to mount, the cost of living rose and the trade imbalance persisted. Economic and political troubles reinforced each other to make Vargas' position more difficult. He had been elected with substantial support, but his popularity declined. He was attacked by the right for his nationalist policies and by the left for his attempt to institute a stabilization program.

Opposition from all sides intensified until, in 1954, a crisis was reached. An attempt on the life of the journalist Carlos Lacerda, an outspoken critic of Vargas, resulted in the death of an air force officer. The assassination attempt was traced to men connected with the president, and the air force demanded he resign. Instead, Vargas shot himself, leaving an emotional suicide note calling "outside forces and interests" responsible for his downfall.

Vice President João Cafe Filho served out the rest of Vargas' term without much incident until, shortly before leaving office, he suffered a heart attack. In the confusion which followed, some military factions attempted to prevent Juscelino Kubitschek, winner of the 1955 presidential election, from assuming office. But Kubitschek was inaugurated as scheduled in January 1956.

Kubitschek was a popular, innovative and energetic leader, and his economic program produced an unprecedented surge of growth. Kubitschek believed that economic development was the key to national independence; despite Brazil's alarming financial situation, and the demands of the International Monetary Fund (IMF), he pursued remarkably ambitious projects. Promising

"50 years of progress in 5," he expanded the highway system and merchant fleet, continued building the steel and oil industries, and created the Brazilian auto industry virtually from scratch. He is perhaps most famous for building the futuristic new capital, Brasilia, in Brazil's underpopulated interior.

All this growth had a high price, however, which became increasingly visible after 1960. Kubitschek's grandiose schemes made the inflation and debt problems worse than ever, while his political style was conducive to corruption and inefficiency. As a result, the early 1960s saw economic growth slow down and then reverse. Political tensions, fed by virulent nationalism and runaway inflation, also contributed to halting economic progress.

The first to address these problems was Jânio Quadros, elected president in 1960. A somewhat erratic political maverick, Quadros was unpopular with Congress. His attempts to stabilize the economy and establish an independent foreign policy (by drawing away from the United States and establishing ties with Communist countries) attracted little cooperation. After seven difficult months in office, Quadros suddenly resigned, gambling that Congress would refuse to accept his resignation.

The Congress failed to respond as Quadros seems to have calculated, however. His resignation was accepted willingly, precipitating a political crisis. Legally, leadership was supposed to pass to the vice-president, João Goulart. But Goulart, a political opponent of Quadros who had been elected separately to the vice-presidency under an unusual provision of the Brazilian constitution, was widely mistrusted. A former minister of labor under Vargas, he was a left-leaning populist whom many suspected of Communist sympathies. Although many in the military favored a coup, a number of officers stressed the importance of obeying the constitution. A compromise, in the form of a parliamentary system designed to reduce Goulart's power as president, was finally reached and Goulart was inaugurated in September 1961. Tancredo Neves, a former Vargas associate who was to become instrumental in the transition back to civilian rule in the 1980s, was appointed prime minister.

The compromise proved a poor solution. Goulart devoted the

first year and a half of his term to battling the parliamentary system, and the economy suffered. Even the restoration of full presidential power in a 1963 plebiscite failed to improve matters, for Goulart was far from skillful politically. Inflation, budget deficits and foreign debt grew out of control, and foreign investors were unwilling to get involved either with the shaky Brazilian economy or with Goulart. This problem was aggravated when Goulart permitted a wave of antiforeign activities.

Both the urban and rural poor, hurt by the skyrocketing cost of living, became restless. Strikes and other signs of unrest grew increasingly common. Goulart tried to respond with a populist call for agrarian and other basic reforms, but this alarmed conservatives, who were concerned and angry as well about the recent growth of the radical left. Finally, many of Goulart's old enemies, particularly the upper class and the anti-Vargas military, had never become reconciled to his victory. When he supported some 1,400 enlisted men in a rebellion in March 1964, many officers united against him. He was soon overthrown by a military coup.

Contrary to Brazilian political tradition, however, the military did not then turn the government over to civilian politicians. For a number of reasons, the military abandoned its traditional "moderating" role in politics and assumed the actual powers of government. The sense of economic and political crisis growing throughout the early 1960s undermined long-held assumptions about the effectiveness and desirability of a civilian system. Many Brazilians felt a need for radical change. The democracy of the second republic had been so superficial and susceptible to distortion that giving it up seemed to many an acceptable price to pay.

Brazil's senior military officers felt somewhat threatened by the trend toward popular mobilization but they also perceived a substantial amount of civilian support and grew increasingly confident about their own ability and presumed right to rule. For 21 years Brazil was governed by an authoritarian military regime. A series of military leaders presided over a period of fundamental transformation in the nation's economy and society.

# 3

# From Miracle to Crisis

Brazil's experience during the past generation was widely heralded, until the 1980s, as a "miracle" of rapid economic growth. More recently, since 1981, some observers have come to regard Brazil as a country deep in crisis. Both of these contrasting visions of Brazil need to be corrected, for each is only partially valid.

Brazil's extraordinarily rapid economic transformation—especially in the late 1960s and early 1970s—seemed miraculous at the time because no developing country of Brazil's size had previously grown for so long at such a pace. Some observers pointed out, even while Brazil's dazzling spurt was still occurring, that whole regions of the country were largely unaffected or adversely affected by the expansion of Brazil's industrial heartland, and that income distribution remained badly skewed or was worsening. But a widespread perception of Brazil until the early 1980s was that it had taken off, that its economic growth had become self-sustaining, and that the benefits of growth would eventually trickle down to all, or at least most, elements in the society.

Brazil seemed a notably positive example of the authoritarian capitalist path to national development. No one claimed that this course was costless, for the fact of systematic political repression was obvious, but this was often portrayed as a temporary, if unfortunate, side effect of economic progress. The harshest aspects of Brazil's authoritarian rule—the exile of dissidents, the detention of political prisoners, the banning of leading political figures from public office, physical torture and other gross and systematic violations of fundamental human rights—began to diminish in intensity and frequency after 1974. A gradual process of political liberalization (*abertura*, literally, opening), a phased restoration of democratic politics, began under President Ernesto Geisel.

The country's continued rapid rate of economic growth, even after the first oil shock of 1973, gave the Brazilian approach considerable domestic and international legitimacy for a time. Brazil's evident economic accomplishments contradicted the arguments of those dependency theorists who had suggested that stagnation inevitably results when international capital penetrates the Third World. No one could deny in the 1970s that Brazil was growing rapidly and that it was adding considerably to its national power. The continuing if somewhat uneven process of abertura, moreover, countered the arguments of those who claimed that Brazil's regime lacked political appeal. Brazil seemed to be well-launched toward national progress. Discussions of U.S. policy options in the 1970s were usually based on the premise that Brazil's course was established and successful.

### *The Miracle: Part Fact, Part Illusion*

Even while it was occurring, however, the Brazilian miracle was partly illusory in three respects.

First, Brazil's rapid economic growth during the late 1960s and early 1970s owed in part to special circumstances, unrelated to the regime's approach to development. The economic spurt was made possible by a temporary confluence of highly favorable factors: pent-up internal demand and underutilized productive capacity due to the 1963-67 recession, coincident with an unprec-

edented increase in international trade and world capital flows. No Brazilian regime could sustain these advantages forever, for they arose not mainly from government policies but from the context of Brazil's expansion.

Second, the transformation of Brazil's economy had human costs well beyond the sacrifice of civil liberties. The Brazilian approach, especially during the "miracle" years, was based on a strategy of development that left a wide gap between rich and poor. Economic production in Brazil during the boom period was consciously directed toward a narrow, high-income slice of the domestic market and toward export markets, not toward broadening national participation in the economy. The regime's economic policies thus had the effect of concentrating income, investment and purchasing power. The poorer half of Brazil's population received 17.4 percent of the national income in 1960, 13.5 percent in 1976, and only 12.6 percent in 1980. The poorest 20 percent of Brazil's population saw its share of national income fall from 3.4 percent in 1970 to 2.8 percent in 1980, while the top 1 percent was raising its share from 14 percent to 17 percent in the same decade, and a new middle class was also being greatly expanded.

Poverty in Brazil was not substantially alleviated even during the boom period. Widespread deprivation persisted. Infant mortality, malnutrition and illiteracy remained high. Brazil's miracle, in short, did not reach all, or even most, Brazilians. Some, in fact, became its victims. Two different countries have come to coexist within the borders of Brazil: a modern industrial power and a large nation of the rural and urban poor.

Third, the political appeal of the military regime proved impermanent. To the extent that Brazil progressed economically, repression and authoritarianism came to be seen as less excusable. To the extent that growth slowed, the regime's main justification for harsh and inequitable policies was undercut. Over the course of several years, the initial coalition that favored the military takeover in 1964—the church, industrial and commercial leaders, middle-class professionals and technocrats—began to split, to become disaffected, and to press for changes. President Geisel's moves toward abertura in the mid-1970s, and the subsequent

acceleration of that process under President João Figueiredo, reflected the weakening of public support for Brazil's military leadership.

### *The Oil Shocks*

Changes in the international economic environment after 1973 combined with and reinforced the structural flaws and policy errors in Brazil's approach to development to plunge the country into increasingly serious difficulties in the late 1970s. Brazil's Second National Development Plan, released in 1973, had postulated an annual growth rate of 10 percent for the next few years. Although this rate was unprecedented for a nation of Brazil's size, it seemed a natural projection of Brazil's experience from 1968 through the early 1970s. These optimistic expectations, however, soon clashed with sharply changing realities. The 1973–74 oil shock abruptly increased Brazil's oil import bill, bringing it to about half the level of the country's total export earnings. Brazil's export potential was simultaneously cut by slowing growth, also a result of the oil shock, in the industrialized market economies in North America, the Far East and Western Europe.

Faced with unanticipated balance-of-payments difficulties, Brazil's first response was to increase its international borrowing vastly, engage in a major new effort at import substitution, cut back its imports and consumption somewhat, and continue diversifying and promoting its various exports. These tactics seemed to work well for a while, as Brazil took full advantage of the recycling of petrodollars (from oil revenue) and of its own export growth potential. Economic expansion was renewed in Brazil, after a brief lull in the mid-1970s, at higher but still tolerable rates of inflation. International bankers had confidence in Brazil's prospects and management, and they had large petrodollar surpluses to invest, both in Brazil and in other developing countries that might import Brazilian exports. Brazil was able for a time, therefore, to finance continued growth at low (even negative) real rates of interest, although shorter-term maturities and variable interest rates made these new loans potentially more costly and thus increased Brazil's vulnerability.

The second oil shock in 1979–80—a 200 percent increase in the price of petroleum—was far more painful, however. Brazil's import bill soared again, while real interest rates began to climb. The lethal combination of higher petroleum prices and substantially increased interest rates consumed virtually all Brazil's export revenues, setting off a downward slide.

Brazil's government then chose to up the ante—to borrow still more in order to cover immediate needs while moving vigorously to stimulate even more exports and, at the same time, trying to curb domestic inflation. International commercial bankers still favored Brazil, making its approach appear viable for a time, although the banks began to increase their "spreads," that is, the charge they imposed above the cost to them of obtaining the capital. The fact that Brazil managed from 1978 to 1981 to double its exports to Latin America, Africa, the Middle East and Eastern Europe temporarily masked the degree of its accumulating financial burden. By 1981, however, the limits of this approach were becoming readily apparent.

***The Economic Bubble Bursts***

The bubble finally burst in 1982. The fatal pinpricks were largely provided by events unrelated to Brazil. One, indeed, was noneconomic: the South Atlantic conflict touched off by Argentina's attempted takeover of the Falkland Islands (Islas Malvinas) in April 1982. The uncertainties precipitated by the South Atlantic war, by Argentina's badly aggravated financial situation and by the deep rift in hemispheric relations that resulted from the U.S. support of Britain strongly reinforced the newly hesitant attitude that commercial banks in the United States and Europe were beginning to adopt in their dealings with all Latin American debtors.

A second and more important pinprick, this one economic, was also unrelated directly to Brazil. When Mexico recognized in August 1982 that it could not meet its international financial obligations (ironically, in part, because Mexico's oil revenues had fallen unexpectedly in 1982), commercial bankers became even more cautious about the entire Western Hemisphere. New loans

to Latin America were delayed or denied, so that the total flow of financial resources to Latin America, including Brazil, dropped precipitously. Loans to Brazil, which had reached $10.5 billion in 1980 and $15.6 billion in 1981, averaged $1.5 billion a month during the first eight months of 1982 but then plummeted to just $400 million a month for the rest of the year. To make matters much worse, Brazil's exports, far from continuing to expand, declined sharply as the sustained world recession caused many of Brazil's trading partners to restrict their imports. The gap between Brazil's revenues and its financial requirements became correspondingly larger.

A third external reason for Brazil's worsening crisis in the early 1980s was the substantial rise in the real cost of capital, stemming in large part from the fiscal and monetary policies adopted toward the end of the Carter Administration and then strongly reinforced by the Reagan Administration. The sharp increase in real interest rates in 1981 (what some have called the Reagan shock) subjected Brazilian loans to even higher costs.

***Band-Aids***

Brazilian authorities responded slowly to the gathering financial crisis. In part, they were inhibited by their understandable desire to project a successful image to the voting public before the November 1982 elections, the first direct elections for state governors since 1966. The regime's effort to enhance its legitimacy through this extension of the abertura process made much sense politically but weakened the government's capacity to conduct national economic policy at a crucial juncture.

A proud but futile effort was made to avoid recourse to the IMF during the preelectoral period. Instead, Brazil attempted to renegotiate its commercial debt with the private banks on the basis of the country's record and prospects. One cost of that strategy was to underestimate substantially Brazil's need for debt restructuring. In order to earn the continued confidence of the financial community, Brazil depicted its plight as less serious than Mexico's. As a result, when Brazil finally was obliged to go to the IMF shortly after the congressional elections, it received

less international credit than it might well have received if its requirements had been accurately portrayed.

Brazil's effort to solve its economic problems with modest measures failed, and the delay in facing reality exacerbated matters. Brazil's economic managers lost credibility at home and abroad. As the months passed, Brazil's predicament was recognized by a widening circle of Brazilians; by commercial banks in the United States, Europe, and Japan; by foreign governments; and by relevant international agencies.

As the extent of Brazil's financial troubles became clear, the underlying structural factors that contributed to Brazil's quandary became more widely understood. The Brazilian strategy of economic growth has primarily emphasized industrial development, much of it in capital-intensive sectors that have been largely dependent on imported material, equipment and technology. Subsidies have been extended to stimulate agricultural and industrial exports, both through direct subventions and through tax exemptions and other indirect devices. Public enterprises have also been favored as a means of rapidly expanding Brazil's production in a number of sectors. Various private enterprises have also been protected through tariffs and nontariff barriers. Massive public investment in infrastructure and in meeting expanding consumer needs (for example, housing for the middle class) and services have led to a significant public deficit, fueling inflation.

As a consequence of all these policies, Brazil's food production for domestic consumption has lagged, many public enterprises have become bloated and some sectors have been allowed to become inefficient.

These economic problems were exacerbated after 1979 by Brazil's response to its worsening balance-of-payments difficulties. Proposals by Finance and then Planning Minister Mario Henrique Simonsen and others to restrict credit and other subsidies as part of a standard inflation-fighting strategy were at first rejected. Instead Brazil chose the approach of the new planning minister, Antonio Delfim Netto, who favored stimulating more rapid growth through cheap credit and various other

incentives. From that decision on, Brazil became locked into a series of measures that depended for their efficacy on a world economic recovery.

### *The Crisis Builds*

From 1979 on, Brazil repeatedly heightened its structural vulnerability by betting on a prompt improvement in the world economy. Each year Brazil came to depend even more on new loans (often at still higher real rates of interest) and on expanding still further its export of products that were subject both to falling world demand and to increasingly protectionist policies in the industrial countries. In 1981, a number of Latin American and European countries tightened import restrictions. As a result, Brazil's export earnings fell by over 13 percent (after average annual increases of about 19 percent in the previous two years), and the country's balance-of-payments deficit grew rapidly. Brazil's financial crisis followed ineluctably.

The extent and gravity of Brazil's economic debacle in the early 1980s should not be underestimated. Inflation from 1983 through 1985 reached over 200 percent a year, a rate unprecedented in Brazil's history. Efforts to curb inflation, moreover, reinforced a severe national depression. Real per capita income fell almost 11 percent from 1980 through 1983 (even more if the terms-of-trade effects are included). Brazil's industrial output in 1983 was at or below the level of 1977. Employment in manufacturing was more than 10 percent below the 1976 level. New investment in Brazil, domestic and foreign, fell dramatically. A record number of firms, including some of the country's largest as well as many smaller companies, filed for restructuring or bankruptcy. State governments and government-run institutions also became very shaky financially. Major export-promotion efforts helped Brazil begin to recover in 1983, and national economic growth resumed in 1984 and accelerated in 1985 and 1986, but major problems still remain and there is always the possibility of a new decline occurring.

Even without renewed deterioration, poverty in Brazil has reached critical dimensions. Infant mortality, life expectancy and

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nutrition indicators show that for many Brazilians conditions have become worse in the 1980s.

Brazil's grim economic situation has had social and political consequences. Food riots and other disturbances rocked São Paulo, Rio de Janeiro, Salvador (Bahia) and other cities in 1983. Such outbreaks have not been sustained, but street crime in urban areas has reached epidemic proportions. The numbers of homeless or abandoned youths are growing. Brazil's social problems are a source of increasing concern.

### *The Military Gives Way*

The process of abertura, begun in the 1970s, became an important outlet for national frustration in the early 1980s. In the 1982 elections, parties opposed to the military government won the governorships of 10 (out of 23) of Brazil's states. These states comprise two thirds of the nation's population and account for almost 70 percent of its economic production and tax base. Opposition parties carried the capital cities in 19 of the 23 states

in the gubernatorial elections of 1982, and won in almost all of Brazil's 80 largest cities.

Widespread repudiation of the military regime—and especially of its civilian economic team which only a few years ago was so widely hailed—became obvious. Polls conducted in September 1983 showed that over 80 percent of the Brazilian public opposed the regime's economic policies. Millions of Brazilians went further in 1984 and demonstrated in mass rallies—the largest in the nation's history—calling for direct presidential elections, a fundamental reform that almost passed in Congress despite the military regime's intense opposition.

In January 1985, Brazil's first civilian president in 20 years was selected, albeit still through indirect elections by an electoral college composed of members of the Senate, the House, and representatives of each state legislature. The choice of Tancredo Neves, a long-time opposition leader with widely recognized political skills and a capacity for consensus-building, seemed to augur well for the restoration of democracy in Brazil. Tragically, Neves—chosen precisely because of the nearly universal respect he personally commanded—became mortally ill on the very eve of his scheduled inauguration and was never able to assume the presidency of the New Republic, the restored civilian regime.

The strength of Brazil's commitment to restoring democracy was demonstrated by the unhindered succession to the presidency of Vice President José Sarney, until a few months earlier a member of the pro-military party. It was further reinforced by Sarney's almost immediate indication that he would be willing to limit his term to four years rather than the mandated six-year term in order that direct presidential elections could be held in 1988.

In its first year and a half in office, the Sarney administration has undertaken significant economic reforms to fight inflation, promoted economic growth policies, initiated an agrarian reform, and begun to attack the problems of gross socioeconomic inequity. The Cruzado Plan, an innovative attempt to reverse inflation without inducing recession through strict controls and a package

of related reforms, has had promising initial results. Efforts to expand Brazil's trade surplus are proceeding well, as are negotiations with the commercial banks to stretch out Brazil's financial obligations.

These efforts have been well-launched, but it is too early to know whether they can succeed. Although Brazil's rampant inflation has been dramatically slowed since the introduction of the Cruzado Plan in April 1986, this has been at the cost of price and wage controls that are already causing bottlenecks, shortages, and labor unrest. Major agricultural gains registered in 1985 could not be sustained in 1986, largely because of drought, but also because of reduced agricultural investment. The industrial recovery has caused plants to function at a level of capacity that cannot be sustained for long, and an expansion of industrial capacity will require major investment in a period when external flows of capital are negligible. Unless Brazil can somehow harness adequate resources for investment and growth on a sustained basis, another economic decline is possible before the end of the decade.

# 4

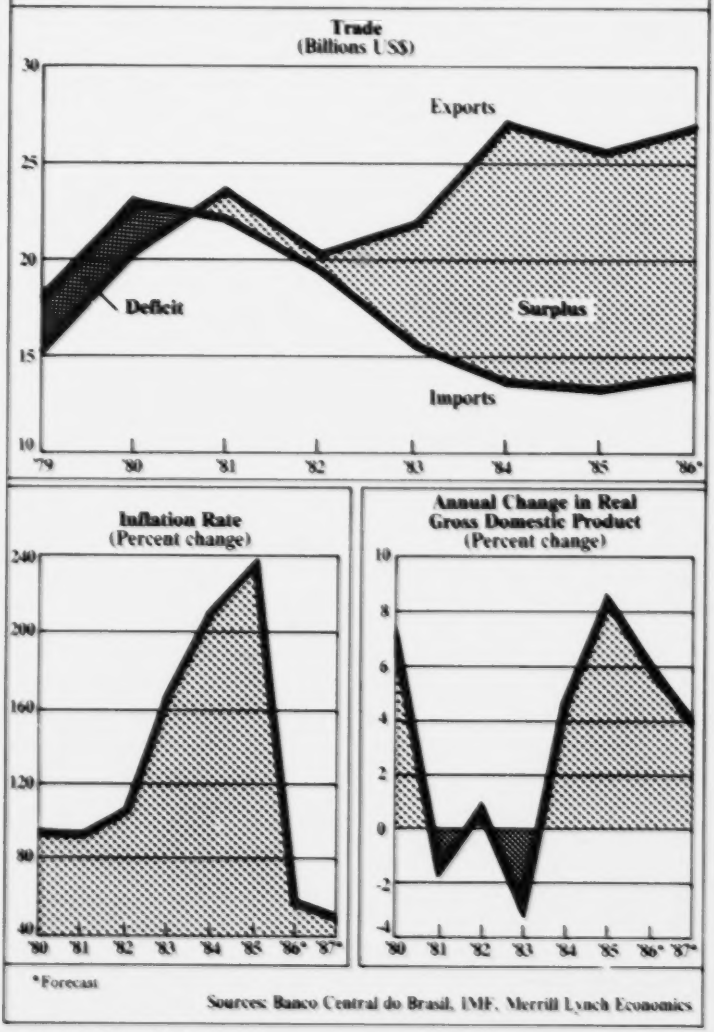
## Brazil Faces the Future

After a generation of remarkable if uneven growth, Brazil has been severely shaken in the 1980s by long-cumulating economic difficulties.

The Brazilian military government's efforts to induce further recession, drastically cut back public expenditures and sharply reduce imports—all to rebalance the country's payments, curb inflation and regain the confidence of foreign investors and lenders—were only partially successful. Brazil's exports recovered and impressive trade surpluses were achieved, but domestic production and employment continued to fall, and government revenues and expenditures declined. High inflation persisted and social problems mounted.

Brazil's economic situation began to improve during 1984 due largely to further reductions in petroleum imports (owing to expanded hydroelectric power, use of gasohol and pure alcohol fuel, conservation and, especially, considerably expanded domestic oil production), the decreased cost of oil, an improvement in the terms of trade of Brazil's agricultural exports, and a surge of exports to the United States. But modest advances in 1984 and even more impressive growth in 1985 and the first

# Brazil's Economy




*Forecast

Sources: Banco Central do Brasil, IMF, Merrill Lynch Economics

Graphs by Bob Mansfield

months of 1986, aided by the drop in the price of oil, have not solved Brazil's fundamental problems. Brazil's economic recovery has been fragile, for it is based partly on an unsustainably sharp reduction of imports and an unusually large increase in exports to the United States, and because inflation has been a difficult problem.

Brazilians are aware that their nation has been paying out more in interest and amortization than it has been receiving in new loans and suppliers' credits. Indeed, some recent studies suggest that even under optimistic assumptions about world economic recovery, Brazil may continue to be a net exporter of capital well into the 1990s, unless the terms of its external debt are substantially renegotiated. Growing protectionist tendencies in the United States and the rest of the Organization for Economic Cooperation and Development (OECD), representing the world's major industrialized countries, further complicate Brazil's prospects, as does the possibility that world interest rates will rise again. Understandably, Brazil has grown skeptical that orthodox recipes can extricate the nation from this difficult pass. A search for viable national options has been taking place.

Brazilians of many differing views agree that the costs of adjusting to the international financial crunch should be shared by the lenders and not absorbed wholly or even primarily by Brazil and other developing countries. They argue that Brazil should seek to restructure its debt substantially, to stretch it out over a number of years and to make its terms less onerous.

Within this overall consensus, considerable debate has taken place about how to extricate the country from its economic difficulties. Brazil has four options—moderate or extreme variants of either an essentially nationalist or a fundamentally internationalist stance.

### *'Moderate Internationalist' Option*

One path, essentially the one followed by the Figueiredo regime, is to play for further time, to muddle through until an eventual international upturn eases the external constraints that contribute to Brazil's plight. To pursue this "moderate interna-

tionalist" course, Brazil would continue to constrict its economy without fundamentally changing its overall orientation. Some state enterprises would be trimmed or sold to the private sector, though the privatization would not be rapid or drastic. Real wages would be cut again, as they were in the early 1980s. Brazil would negotiate periodically with commercial banks and international institutions in order to obtain relief if and when a gap returns between the country's earnings and its international financial obligations. Brazil would count on world economic recovery to expand markets for its exports and facilitate access to additional external capital. In the meantime, Brazil would continue to accept the established rules of the game in international trade and finance. It would not default, delay payments inordinately, or declare a unilateral moratorium, nor would it erect higher protectionist barriers.

Because this course demonstrably failed to achieve economic recovery, domestic resistance to the policy rose steadily during the latter years of the Figueiredo government. In August 1983, the Brazilian Congress indicated for the first time in 15 years that it would reject a government proposal—specifically, a new wage law intended as part of the austerity package then being negotiated with the IMF. In October 1983, the Congress actually did reject a government-decreed austerity wage law, despite the regime's imposition of state-of-emergency restrictions in Brasilia that surely would have intimidated Congress in previous years.

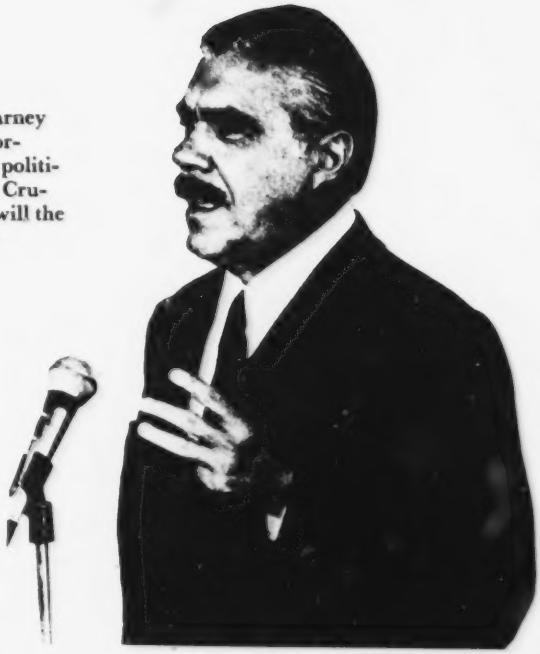
Both presidential candidates in the indirect election of January 1985 won nomination in 1984 on platforms critical of the Figueiredo regime's economic policies; if the new civilian regime were to revert to those policies, this move would be strongly opposed by the same congressional coalition that produced a civilian victory. In short, the economic policies Brazil followed from the beginning of the crisis until mid-1985 are no longer politically feasible. The resignation of Brazil's finance minister and the president of the Central Bank in August 1985, early in the Sarney administration, in fact, signified the rejection of the moderate internationalist course on which Brazil had relied for a generation.

### *'Extreme Internationalist' Course*

A second theoretically possible but also probably unfeasible course would involve opening Brazil's economy much more fully to international competition by sharply reducing protectionist policies and drastically cutting back the public sector. This "extreme internationalist" policy, akin to the approach adopted in Chile, Argentina and Uruguay during the mid-1970s, would shake down the Brazilian economy through the relentless discipline of the free market. The aim would be to force Brazil to emphasize sectors of production for which it has a natural competitive advantage, thus enabling it better to survive the ups and downs of the world economy. Expansion of foreign investment would be encouraged by lifting restrictions on the operations of foreign firms and on the remittances of profit.

Although some elements of Brazil's private sector are attracted by this approach and external pressures are occasionally exerted on its behalf, it is noteworthy how little support this recipe has in contemporary Brazil. Organized labor, the church, the state technocracy and much of the entrepreneurial community would all strongly oppose such a policy, which could, therefore, be adopted only by reversing the abertura. Brazil's military hierarchy understands, however, that it would be much harder to take over today than it was in the 1960s—particularly now that the abertura process has finally brought a civilian president to power. Because Brazil's society is so much more modern, mobilized, integrated and complex than it was in the 1960s, and because the institutions of the civil society are so much more developed, a restoration of hard-line authoritarianism would be difficult and costly.

Adoption of the extreme internationalist economic approach would be unlikely even if elements within the armed forces were somehow to reintroduce harsh authoritarian rule. The military officers most disposed toward opening up Brazil's economy are precisely those also most committed to a political opening. The officers who would be brought to power by an unlikely reversal of abertura would be against an extreme internationalist policy and inclined instead toward autarchic economic policies.



**President José Sarney has benefited enormously from the political success of his Cruzado Plan—but will the momentum last?**

Reuters/Bettmann Newsphotos

### *A New Emphasis on Growth*

Brazil is turning, therefore, toward a somewhat more inward-oriented, nationalist approach toward stimulating growth. The elements of such a new economic strategy have been widely discussed in Brazil during the past several years, particularly during the 1984 presidential election campaign. Although he presented no detailed economic plan, Neves as a candidate associated himself with the moderate nationalist approach, as has President Sarney, especially after his first three months in office.

Advocates of a new Brazilian development strategy argue that Brazil's internal market should be significantly expanded through redistributive measures which, if implemented over several years, should not be inordinately disruptive or expensive. Such reforms, they claim, could significantly raise the standard of

living of Brazil's poorest and of its lower middle class within one generation. Basic services would also be improved, enabling millions of Brazilians to produce and consume more.

According to this view, sustained public investment in primary education, urban and rural water supplies, health care, nutrition and public transportation—and the strengthening of the agricultural sector through agrarian reform and investment in irrigation and infrastructure—could immediately provide increased employment. Over time, this investment could contribute to enhanced productivity and could considerably expand the domestic market for Brazilian-made goods. Such measures would also entail much less energy and import requirements per unit of output than the capital- and energy-intensive growth strategy Brazil has been pursuing. Finally, this approach to development, it is argued, would leave Brazil less vulnerable to external factors—commercial, financial or political.

Proponents of a nationally oriented shift in Brazil's economic strategy share two basic assumptions: that the country's size makes a more inwardly directed policy viable, and that international exigencies now make this tack advisable. In this view, the trends during the past generation toward urbanization, mass education, infrastructural improvements and the reduction of regional disparities have set the stage for an appreciable expansion of the local market. Brazil's continuing inequities and lags in development provide considerable potential for further expansion. On the other hand, international conditions are such that no demonstration of Brazilian austerity can possibly induce a major net inflow of long-term capital. Efforts to contract Brazil's economy faster than that of the rest of the world are not only useless but counterproductive. They hurt Brazil, they make the repayment of debt even more difficult, and they help to stifle world recovery.

Advocates of a new Brazilian growth strategy disagree on a number of issues: how much emphasis should be given to the export sector; what kind of foreign exchange policy to pursue; how far to cut back the public sector; how and to what degree to realign wages; how to treat multinational corporations; how to

deal with technology-transfer issues; and, especially, how to handle Brazil's staggering debt. Differences on these issues exist at many points on a spectrum, but the basic options cluster around two distinct positions.

### *'Moderate Nationalism'*

The "moderate nationalist" approach recognizes the continuing importance to Brazil of a strong export sector, foreign investment and technology, and access to international capital markets. Moderate nationalists, including most of the leadership of the party of the Brazilian Democratic Movement (PMDB), Brazil's main opposition party during the last several years and now a major force in the Sarney government, do not seek to isolate Brazil from the international economy, but rather to improve the terms of Brazil's interaction with creditors and commercial partners. They do not propose repudiation of the debt or even a unilateral moratorium. They push, instead, for a negotiated delay in repayment and a considerably restructured debt. In place of the combination of tacit moratoria and short-term adjustments that have characterized Brazil's policy during the past few years, they seek a multiyear extension of the debt, lowered interest rates and repayment at a pace that will leave Brazil with enough export earnings to permit resumed growth. Moderate nationalists recognize that export imperatives require continued austerity for Brazil in the coming years. But they propose to limit the costs of Brazil's sacrifice by extending the debt to gain breathing space, sharing the necessary sacrifices more equitably within Brazil, and compensating somewhat for these sacrifices with welfare and redistribution policies.

Moderate nationalists differ from the moderate internationalist policies of the Figueiredo regime mainly in emphasis. Moderate internationalists by now recognize that full integration into the world economy is not sufficient to resolve Brazil's development problems, whereas moderate nationalists increasingly accept the need to retain an export orientation. The elements of a consensual position on Brazil's economic future have begun to emerge, therefore.

### *Autarchy*

More-extreme nationalists, on the other hand, doubt that continued dependence on international finance and trade still serves Brazil's interest in this period of sustained global recession. They emphasize that without major changes in policy, Brazil is likely to be a net exporter of capital for the next 15 years, even if the developed-world economies do well. Under these circumstances, they point out the potential benefits of repudiating Brazil's debt, either unilaterally or in agreement with other major debtors, as part of a debtors' cartel. They favor much tougher policies toward multinational corporations to make them more responsive to Brazil's interests. They propose populist approaches to wages, exchange rates and public spending—all to encourage nationally oriented production.

Proponents of this autarchic approach recall that Brazil reacted to the Great Depression of the 1930s by turning sharply inward, with very favorable results. Brazil then insulated itself from many of the depression's costs and began a period of import substitution that provided a long-term boost to the country's economy. Arguments for a return to an inward-oriented stance, however, tend to underestimate the changes that have occurred in the last half century. Because of its new reliance on sophisticated imported technology and on exports as well as on external capital, Brazil is far more dependent on the international economy than it used to be. Even so, a nationalist stance of withdrawal from the world economy would strike a responsive chord in some sectors of Brazil, especially if a prolonged recession again loomed on the national horizon.

### *Sarney's Future Course*

Economic and political circumstances in Brazil and elsewhere make more-nationalist and inward-oriented economic policies increasingly probable. The most likely course, under currently foreseeable circumstances, is a moderate nationalist approach of the sort put forward by the PMDB, endorsed by significant segments of the PDS (the government party during the years of military rule) and then initiated by President Sarney's govern-

ment. Under this moderate nationalist course, Brazil will seek to expand its domestic economy and make it more equitable without neglecting the export sector or isolating the country from the international economy. Brazil will endeavor to expand its domestic market, to respond more actively to social needs, to strengthen agriculture and to increase domestic savings.

If Brazil sustains a moderate nationalist approach, it will continue to engage in tough bargaining with its international creditors, foreign investors and exporters regarding the exact terms of the country's continued integration into the international economy. Brazil will increasingly insist that a satisfactory rate of national growth is its primary economic objective and that other goals are subsidiary. U.S. banks, investors and exporters will be forced to struggle with Brazil over rates of interest, spreads, fees, remittances, protectionist barriers, export and local content requirements, reserved sectors, transfer pricing and a host of similar details. Brazil's insistence on more-favorable terms will probably become more firm in the light of increased public pressure. It is likely, therefore, that more conflict, not less, will characterize U.S.-Brazil relations.

# 5

# The United States and Brazil: From Easy Alignment to Managed Conflict

Until this last generation, U.S. investment in and trade with Brazil were relatively modest. Migration between Brazil and the United States has been scant, and tourism has never been significant. Few U.S. groups or institutions have been so deeply engaged in Brazil as to make Brazil's domestic economic or political orientation important to U.S. politics and policymaking. In short, the consequences for the United States of Brazil's internal trends have never been very great.

Until the past few years, U.S.-Brazil relations have primarily involved cooperation in foreign policy. For most of this century, the two countries were closely aligned on a wide range of international issues. Brazil's great foreign minister, Barão do Rio Branco, built his country's international posture early in the 20th century around an avowed "special relationship" with the United States, and this stance was often reinforced over the years.

For its part, the United States also singled out Brazil. The United States was the first country to recognize Brazil's indepen-

dence in 1824 and the first power to recognize the Brazilian Republic in 1890. Brazil was the first (and long the only) country in Latin America with which the United States exchanged full-fledged ambassadors. In the mid-1930s, Brazil was the first nation with which the United States negotiated a reciprocal trade agreement to lower tariffs.

Washington intensified its interest in relations with Brazil in the late 1930s when the hemispheric ramifications of the deepening European crisis became clear. Increasing German trade with Brazil (rising from 14 percent of Brazil's trade in 1935 to 25 percent in 1938, slightly more than the U.S. share in that year) aroused Washington's concern, as did Brazilian purchases of arms from Germany. The United States was also alarmed at the possibility of increasing German cultural and ideological influence on Brazil, especially within the armed forces. The United States began actively to seek Brazil's cooperation in order to curb Nazi influence, assure U.S. access to Brazil's natural resources, deny those to Germany, protect Brazil against German attack, and secure the right to build military bases and other facilities in Brazil's northeast.

For a while, the Vargas regime played Germany and the United States off against each other, but by 1940 Brazil opted for a closer relationship with Washington. The United States responded to this decision by supporting the price of coffee, supplying economic assistance for the Volta Redonda steel mill project, providing significant amounts of weapons, and aiding in the construction of airfields and other facilities. In addition, Brazil's government enjoyed enhanced domestic and international status as a close ally of the United States. After the United States entered World War II, Brazil on its own initiative became the only Latin American nation to send troops (over 20,000) to fight in the European theater.

During World War II, three fourths of all U.S. military aid to Latin America went to Brazil. U.S. forces were based in Brazil, U.S. military and economic missions proliferated, and extensive bilateral public and private sector economic cooperation occurred. Public opinion in Brazil supported this alliance, as did Brazil's

military leaders. Washington took note of Brazil's sensitivities, and accorded Brazil enough symbolic and rhetorical attention to meet Vargas' own political needs.

***Postwar Friction***

Following World War II, however, differences between Brazil and the United States began to appear. One source of friction was political, as the worldwide U.S. commitment to the Four Freedoms, including freedom of speech, added to the pressure against the Vargas regime and contributed to his ouster in 1945.

More important, differences regarding economic interests arose. Brazil sought to parlay its supposed special relationship with the United States into meaningful economic assistance, through aid, loans or preferential trade arrangements. Washington, however, was by then more concerned with Europe and the Far East than with Latin America. The U.S. government wished to rely mainly on the private sector to promote U.S. interests in the Western Hemisphere, and on free trade to promote world commerce. Washington was unwilling to provide substantial economic or trade concessions to Brazil; only $184 million was extended to Brazil in economic assistance and loans from 1946 to 1952, compared with over $13 billion provided to European nations under the Marshall Plan. Some symbolic attention was still paid to Brazil but its substantive aims were largely ignored. When the worldwide economic and political interests of the United States clashed with Brazil's expectations, the latter always got short shrift.

Nationalist resentment of the United States began to accumulate in Brazil during the late 1940s and early 1950s. That the resentment did not build even faster owed in part to Brazil's rapid postwar economic advance, which was fueled by the large dollar, gold and sterling balances amassed during World War II and by the increased value of Brazil's exports after the war and during the Korean conflict. The postwar period also saw rapidly growing U.S. investment in Brazil, bringing U.S. firms into a dominant position among foreign investors for the first time. The new U.S. prominence in Brazil's economy made bilateral relations closer,

but also provided an additional source of friction. The Brazilian government under Vargas—back in office as an elected president—began to undertake restrictive measures to control foreign investment and, particularly, to build up state corporations.

***Managed Conflict***

From the late 1950s to the present, U.S. relations with Brazil have changed fundamentally, primarily as a result of Brazil's internal transformation. As Brazil's political economy has changed, the U.S. role in Brazil's economy has been altered, Brazil's international interests have become more complex, and U.S.-Brazil relations consequently have been affected. Except for a brief parenthesis right after the military takeover in 1964, Brazil has moved during the past generation toward an increasingly independent and assertive stance. Tensions have grown between Brazil and the United States on specific issues, mainly economic in content. Usual (if not automatic) alignment between Brazil and the United States has been replaced by frequent conflict, limited and managed, but nevertheless real—and growing.

During the 1950s and early 1960s, the United States began to become concerned about signs of rising economic nationalism and political independence in Brazil, first under Vargas, then under Kubitschek, more intensely under Quadros, and finally and most dramatically under Goulart.

During the Vargas presidency, increasing pressures grew against U.S. investment, and splits developed within the Brazilian military between pro-United States officers and a more nationalist cadre. These splits, in turn, eventually contributed to the weakening of the Vargas regime and ultimately, in August 1954, to the suicide of Vargas.

The Kubitschek period saw an improvement in U.S.-Brazil relations but also deliberate efforts by the Brazilian government to diversify its economic, political and military ties in this hemisphere and in Western Europe. The latter trend was carried much further during the brief presidency of Quadros, who opened diplomatic and commercial relations with the Soviet

Union, Cuba and various other Communist countries, and vigorously expanded Brazil's contacts with the Third World, especially with Africa. The Quadros regime ended abruptly, however, when the president resigned, warning that "terrible forces," including "foreign ones," were trying to frustrate Brazil's progress.

Frictions between the United States and Brazil deepened further during the presidency of Goulart, Quadros' vice-president. These tensions mounted over Brazil's nationalization of U.S. public utility investments, restrictions on profit remittances, the conditions for U.S. economic assistance and broader international issues. More important, the Kennedy Administration was deeply troubled by the inclusion in Goulart's entourage of alleged Communists and Communist sympathizers. As the Goulart regime moved to more-radical domestic and foreign policies and retained personnel that the U.S. government considered suspect, Washington increased its distance from the Brazilian government. By March 1964 the U.S. government was sympathetic toward, and seems to have been prepared to support, if necessary, the military coup that overthrew Goulart in favor of General Humberto Castelo Branco, an officer in the Brazilian unit that had fought alongside the United States in Europe during World War II.

***Post-Coup Rapprochement***

Under the Castelo Branco government, Brazil returned to a closely collaborative relationship with the United States. The new ties were exemplified by Brazil's decision to send troops to join the U.S. occupation of Santo Domingo in 1965, and to accept having a Brazilian general appointed to head the Inter-American force there. Brazil's new military rulers not only shared U.S. concepts of ideology and security but accorded these issues the same prominence as U.S. policymakers did.

By the end of the 1960s, however, the renewed U.S.-Brazil alignment began to unravel again. Domestic opinion in Brazil and world rejection of the U.S. role in Vietnam helped weaken the U.S.-Brazil bond, as did the replacement of General Castelo

Branco, an especially close friend of the United States, by General Artur da Costa e Silva. The key reason for the emerging bilateral frictions, however, was Brazil's pursuit of its own concrete interests on a widening range of issues. Despite the ideological and even the personal predilections of its military rulers, Brazil found itself by the 1970s differing with the United States, within an amicable framework, on numerous specific questions.

The particular circumstances of bilateral conflict have varied, but there has been a common thread. Brazil and the United States have clashed repeatedly over Brazil's determined efforts to secure maximum scope for its expansion as an independent industrial power:

- Brazil has pushed—in the UN, in the General Agreement on Tariffs and Trade (GATT), in the IMF, in the World Bank and elsewhere—to restructure international organizations to provide greater participation and influence for developing countries.
- Brazil has been active in various international negotiations on trade, finance and basic commodities, as well as in broad North-South economic deliberations. It has acted often as a Third World power, critical of the approach of the advanced industrial countries.
- Brazil has resisted efforts led by the United States and other industrial countries, in the UN and elsewhere, to impose ecological and population policies that Brazilians fear would restrict their nation's options for growth.
- Brazil has played a leading role in pushing for international agreements on the Law of the Sea that would strengthen the position of developing countries in the management of ocean resources and the sharing of revenues.
- Brazil has refused to put into effect the Tlatelolco accords against nuclear proliferation in the Western Hemisphere and has opposed U.S.-led attempts to restrict its access to certain types of nuclear materials and technology, restrictions the United States claims are necessary to prevent the spread of nuclear weapons.
- Brazil has also differed with the United States for many years on several political matters. It has expanded (albeit slowly) its diplomatic, commercial and cultural relations with the Soviet

Union and various East European nations. Brazil ignored the U.S.-inspired grain embargo imposed on the Soviet Union in 1980 as well as the U.S.-sponsored boycott of the Moscow Olympic Games in that year. Brazil has contradicted the U.S. approach to the Middle East by voting at the UN in the mid-1970s to condemn Zionism as a form of racism, by accepting the Palestine Liberation Organization as a legitimate representative of the Palestinian people, and by developing close commercial links (including the export of arms) with Libya, Iraq and several other Arab nations. Brazil was the first non-Communist nation to recognize the MPLA (Popular Movement for the Liberation of Angola) regime in Angola in 1974, and has subsequently kept its distance from U.S. policy regarding the Cuban presence there. In the early 1980s, Brazil resisted the notion that a South Atlantic treaty organization, including South Africa, be formed. In the mid-1980s, indeed, Brazil is pushing the idea of a nuclear-free zone in the South Atlantic, a concept strongly resisted by the United States.

● Most important, Brazil and the United States have disagreed on a variety of specific economic concerns. The United States has objected often to Brazil's practice of subsidizing exports, and to Brazil's protection of its own domestic markets through tariff and nontariff barriers. Brazil has complained with equal vehemence about U.S. protectionism, including the use of countervailing duties and quotas to limit imports on a range of products, including sugar, footwear, textiles, ethyl alcohol and specialty steel. Brazil and the United States have clashed, as well, on profit remittances by U.S. firms; on the terms of technology transfer; on regulations affecting U.S. banking and other services; on Brazilian efforts to bar foreign firms from particular sectors of the economy (commuter aircraft, small computers and data processing or "informatics" more generally); and, with increasing frequency and intensity, on trade competition in third markets.

***Divergent Interests***

All these bilateral tensions—exacerbated since 1979 by continuing negotiations over the terms, timing and cost of refinancing

Brazil's massive foreign debt—arise naturally from the changing economic interests of the two countries' firms, banks, consumers and trade unions. The interests of all these economic actors are competitive, not automatically compatible, and the intensity of conflict among them tends to increase as the level of economic interaction rises. The resulting frictions are manageable through negotiation on specific matters. But the conflicts are far from trivial, for they involve the allocation of costs and benefits between the two nations and among sectors within each country.

Washington has been slow to understand how deeply rooted are the issues in contemporary U.S.-Brazil relations and how firmly committed Brazil is to pursuing its own interests. At the onset of significant tensions with Brazil in the early and mid-1970s (actually a return to the pattern preceding the military takeover in 1964), the United States failed to recognize their fundamental nature and instead used mainly procedural devices to improve the relationship. The Kissinger-Silveira "memorandum of understanding" (1976) epitomized this U.S. reaction, for

Courtesy Brazilian Consulate General, New York City

**Inside a nuclear power plant. After the Chernobyl accident in the U.S.S.R., Brazil put most of its $25-billion effort to build nuclear reactors on hold.**

it concentrated entirely on visible bureaucratic procedures for dealing with bilateral concerns. This tack did, in fact, temporarily improve the climate of bilateral relations. Substantive frictions between the two countries persisted, however. Neither country significantly modified its policies affecting trade, finance, technology or related matters, and Brazil was determined to continue enlarging its autonomy in foreign policy.

Tensions between Brazil and the United States mounted during the early Carter Administration. First the U.S. government attempted, without consulting Brazil's government on the matter, to persuade West Germany to break its contract to provide sensitive nuclear technology to Brazil. Then Washington aggravated relations by heralding its human rights policy in ways Brazil's government found offensive. These two specific irritants were considerably alleviated in the course of the Carter period, but the underlying economic conflicts continued and the nuclear issue also remained divisive. The United States and Brazil were still at odds at the end of the 1970s.

***The Reagan Honeymoon***

The Reagan Administration entered office in 1981 avowedly committed to restoring the erstwhile "beautiful relationship" by revising those U.S. policies particularly irritating to Brazil. The new Administration quickly tried to improve bilateral communication. General Vernon Walters, a favorite of Brazil's military leaders ever since his service as liaison officer with the Brazilian forces during World War II, was dispatched as a special emissary. Vice President George Bush announced in Brasilia that U.S. firms would be granted an exception to allow them to transfer nuclear fuel to Brazil. Reciprocal state visits by Presidents Figueiredo and Ronald Reagan were arranged.

It soon became evident, however, that Washington's main concern was to gain Brazil's cooperation regarding the South Atlantic, Central America, Cuba and East-West relations in general, and that the United States was not prepared to change policy on the underlying economic issues important to Brazil. The classic pattern of U.S.-Brazil relations thus repeated itself. Wash-

ington ostentatiously adjusted its symbols and its rhetoric but did not meaningfully amend its substantive economic policies toward Brazil. On matters importantly affecting Brazil, such as the pleas for substantial additional resources made by the IMF in the autumn of 1982, U.S. policy did not change much.

As the acuteness of Brazil's financial crisis became evident late in 1982, the Reagan Administration finally responded, as it had earlier in the case of Mexico, with an emergency package of *ad hoc* assistance. Bridge loans (short-term loans to help countries over rough financial periods when they are close to economic adjustment pacts with the IMF) to Brazil totaling $1.2 billion were announced by the U.S. Treasury in December 1982 and early 1983 to help ease the immediate shortfall of foreign exchange. But the loans barely compensated, in effect, for the adverse impact on Brazil of the high interest rates produced by Reaganomics, a combination of lower taxes and higher budget deficits. Additional loans and guarantees were also provided by the Export-Import Bank of the United States, but these have been of very limited relevance to Brazil; they were hardly utilized, and when used merely helped Brazil afford to continue to import goods from the United States.

The basic economic issues that concern Brazil in the 1980s—improving the terms of the massive foreign debt and expanding the market for its exports in advanced industrial countries, including the United States—have not yet been squarely addressed by the U.S. government. On the contrary, protectionist sentiments have been intensifying in the United States, and Washington has so far been largely unresponsive to calls for a broad restructuring of international finance.

### *'Baker Plan'*

The Baker Plan, the proposal offered by Secretary of the Treasury James A. Baker 3d at the annual meeting of the World Bank and the IMF in October 1985 in Seoul, South Korea, is the most significant step taken by the United States so far toward an adequate response to the problems of Brazil and other developing-country debtors. The plan calls for commercial banks and

international financial institutions to provide an additional $29 billion during the next three years to 15 developing countries, 10 of them in Latin America. The proposal does recognize the developing countries' priority of resuming growth and the need to channel additional financial flows to them in the years ahead. But the Baker Plan is too limited in concept and in magnitude to meet the needs of Brazil and other major Third World debtors. It is estimated that Mexico alone will require half the sum suggested in the Baker proposal for all 15 nations. Much more international credit, on a long-term basis, will be required if Brazil and other developing nations are to resume growth.

# 6

# Options for U.S. Policy

Brazil, by far the largest country in Latin America and one of the most important countries in the Third World, is at a crossroads. Rapid growth and fundamental transformation during the 1960s and 1970s made Brazil increasingly powerful, self-confident and assertive. Basic flaws in Brazil's approach to development and sustained adverse conditions in the world economy, however, produced major economic and social problems in the 1980s. Brazil's politics have evolved toward greater popular participation and governmental responsiveness. But Brazil's first civilian president in more than 20 years must govern at a time when economic problems and constraints are challenging.

### *The U.S. Stake in Brazil's Future*

The political and economic choices Brazil makes now will not only shape Brazil's course but will also affect the future of Latin America as a whole as well as the interests of the United States.

Whether Brazil continues the process of democratization, as it has for a decade, or reverts instead to authoritarianism, will influence all of South America. The renewed regional appeal of democratic processes has been strongly affected in recent years by

Brazil's slow but steady return to democracy, and this trend will be reinforced if Brazil adheres to this path. Conversely, the regional climate for democracy and for the protection of fundamental human rights would deteriorate sharply if Brazil returned to authoritarian practices.

The regional effects of Brazil's choices regarding finance, trade, investment, technology and related issues will also be important. A moderate nationalist approach, particularly if worked out in concert with international actors, would help other Latin American countries adopt similar policies, compatible with a reexpansion of the international economy. An extreme nationalist turn in Brazil, on the other hand, would no doubt legitimize that option elsewhere in the region; it might even lead to a debtors' cartel and other forms of South-South cooperation at the expense of the established international system. The chances that nationalist, populist and anti-American movements might gain strength elsewhere in Latin America would be increased if Brazil veered in that direction. Populist and anti-American currents already evident in Peru and Argentina (and latent in Chile) would gain internal credibility and external support if Brazil adopted an extreme nationalist course.

Brazil's choices regarding democratic politics, general economic orientation, debt and trade, foreign investment and technology transfer will significantly affect the United States. This is true both because U.S. banks, exporters and investors have major direct interests in Brazil and because Brazil's international weight and influence have become so substantial. Brazil's economic difficulties have already reduced U.S. exports, slowing economic growth and increasing unemployment in the United States. More U.S. investment is concentrated in Brazil than in any other Latin American country and most of it depends for its profitability on a Brazilian economic recovery. U.S. banks obviously have an enormous stake in Brazil's economic future. How Brazil behaves and fares will also affect the future of many other Third World nations.

U.S. policy, in turn, will be significant for Brazil. The United States is still Brazil's single largest market, its biggest supplier of

goods and services, and its primary source of investment and finance. Although Brazil is far from a U.S. dependency, it is influenced strongly by U.S. policies on fiscal and monetary issues, trade, energy, technology transfer, resource development and, above all, debt.

### *U.S. Options*

The United States has three broad options for structuring its future relationship with Brazil. It could maintain, in one form or another, its long-established stance, one that combines rhetorical deference with actual disregard for Brazil's substantive needs. It could attempt instead to establish a new and truly preferential bilateral relationship with Brazil, significantly changing U.S. policies to meet Brazilian aims. Or the United States could design new general policies, not specifically directed at or limited to Brazil, to deal with the basic problems faced by Brazil and other advanced developing countries.

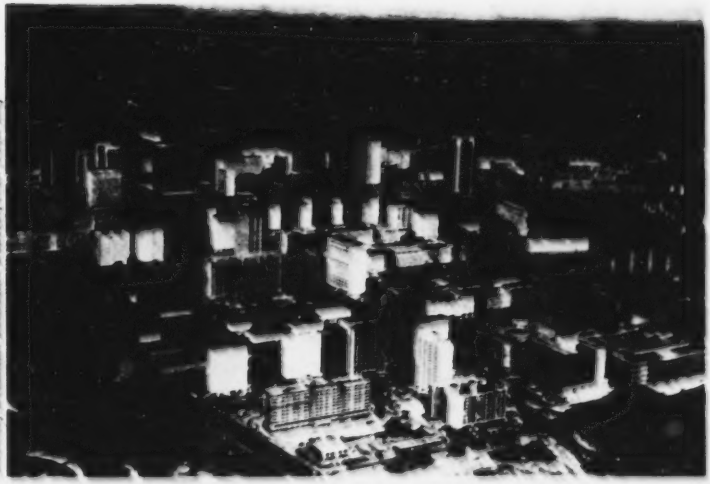
When it follows its traditional policy, the United States pays special verbal and procedural attention to Brazil, but stops short of commitments involving significant costs to the United States. Brazil's economic development continues to be encouraged, but it encounters protectionist reactions when it demonstrates a competitive advantage in a specific product of some importance. Under this approach, the United States occasionally makes ad hoc concessions to Brazil on specific items, but these are considered exceptions; the emphasis is on restoring business as usual between the two countries. This has been the case so far with regard to Brazil's overwhelming external debt. Washington helped to arrange emergency bridge loans at the height of Brazil's liquidity crisis at the end of 1982, but it has preferred since then to let commercial banks work out their own relations with Brazil.

If the United States persists in this approach to Brazil, future relations may well continue much as they have for the last few years: generally cordial in tone, increasingly conflictual on specific matters, mostly lacking in creative efforts to develop mutual interests, but usually free also of intense struggle. Brazil would continue to be treated routinely by the United States, with

high-level attention confined largely to the ceremonial. Brazil would increasingly go its own way, and the United States would from time to time be surprised at Brazil's assertive independence, but the pattern of relations would almost certainly be tolerable.

It is possible, however, that a continuation of the classic U.S. approach could inadvertently help push Brazil toward an extreme nationalist course that would cause much deeper conflict between the two countries. Many Brazilians have come to perceive that U.S. fiscal and monetary policies in effect tax Brazil and other countries through high interest rates to pay for the U.S. Federal deficit. Protectionist U.S. and OECD trade policies are thought to thwart some of Brazil's export possibilities. The United States has on several occasions opposed increased resources for the World Bank and the IMF, blocked reforms that would make those agencies more responsive to Third World demands, and resisted broad proposals to restructure the external debt of developing countries. If the United States pursues such policies, Brazilians may blame the resulting stress not on neutral market forces but on the United States.

Under these circumstances, Brazil would surely intensify its pleas for relief, particularly improved access to capital and markets. If the United States and other international actors then remain unresponsive, Brazil's internal political dynamics could conceivably push it toward extreme nationalism. Brazil's political history includes a substantial tradition (epitomized by the suicide of Vargas and his references to "outside forces") of pointing to external causes for Brazil's troubles. If Brazil's situation worsens, an extreme nationalist turn could eventually occur. Brazil might consider a moratorium or a repudiation of the foreign debt, highly protectionist trade policies, harassment or expropriation of foreign investments, and perhaps radical policies on other international issues. Such a "beggar thy neighbor" approach is not now favored by most Brazilian leaders, for they understand that it would probably be self-defeating and ultimately unviable. But continuing U.S. policies that many Brazilians regard as insensitive or punitive could contribute to such a response—and that would certainly hurt the United States.



Courtesy Brazilian Consulate General, New York City

**Brasilia: Inaugurated as Brazil's capital in 1960 in an effort to encourage the development of the country's interior.**

The second option, the proposal that the United States and Brazil resurrect a special relationship comparable to that briefly experienced during World War II, is favored by a few Brazilian and U.S. business executives, and it would be consistent with periodic U.S. rhetorical deference to Brazil. This approach would provide Brazil with preferential access to U.S. finance, technology, energy, arms and markets in exchange for privileged U.S. access to Brazil's markets and raw materials, diplomatic support and security cooperation. Brazil unsuccessfully sought this type of relationship after World War II, and Brazil's military government of 1964 also wished to achieve it.

By now, however, the interests of both Brazil and the United States are too diverse and complex to sustain a truly preferential arrangement for long. Both nations have too many other commitments to cut meaningful, lasting bilateral deals. The United States has major involvements throughout the world, while Brazil now has important ties in Africa, East Asia, and the Middle East, and a growing stake in improving its relations with the rest of

Latin America. Neither country could afford to make genuinely preferential agreements that would undermine its interests and commitments elsewhere.

A special relationship would predictably break down, as it did after World War II, because other interests would get in the way of a sustained U.S. commitment. Brazil, too, would find its own reasons to escape such provisions. Moreover, a Brazilian government would be especially vulnerable politically if it sacrificed Brazilian interests to keep a bargain on which the United States eventually might welch. In any case, the special relationship path is currently moot. The Sarney government wants to assert its independent foreign policy stance, not to align more closely with Washington.

It would be in the best interest of the United States to take the third course. New general policies are needed to address fundamental needs Brazil shares with Mexico, other major Latin American nations, and advanced developing countries elsewhere in the Third World. The United States should help reform international economic relations so that Brazil and other Third World nations can resume economic growth and development, regain solvency and work cooperatively with the industrial countries to reexpand international economic exchange. Instead of reacting to economic setbacks in newly industrial countries with niggardly attempts to protect the faltering old order, the United States should move boldly and positively to help refurbish and thereby strengthen the international system.

### *A Three-Step Strategy*

This is not the place to discuss in detail a full strategy for U.S. relations with the developing countries. Three specific steps may be highlighted here, however, because they are particularly important for Brazil and for Brazilian-U.S. relations.

First, and fundamental, the United States must reduce its enormous public-sector deficit which inevitably affects international interest rates. Until the United States puts its own house in order, the strain that high real interest rates place on the solvency of Brazil and other Third World debtors cannot be relieved.

Second, the U.S. government should take a leading role in resolving the problem of Third World debt. Various schemes have been proposed for dealing with this issue. All share several key points: to extend the maturities of current Third World debt; to add back (unpaid) interest to principal due, shifting the country's obligation from the short term to the long term; to expand official flows of capital through the IMF, the World Bank and the regional development banks; to reduce interest rate spreads above market rates to a level closer to the commercial lenders' costs of securing capital; to reduce or eliminate management fees for refinancing; and in general to help provide the breathing space necessary for Brazil and other developing countries to resume economic advance. None of these steps should be beyond the innovative capacity of current governments, international institutions and commercial banks, but they are unlikely to occur unless the government of the United States takes a strong initiative. The Baker Plan, a step in the right direction, should be followed by concrete and more-extensive measures to reverse the flow of resources from Brazil and Latin America to the United States and other industrialized countries.

Third, the United States should continue to resist protectionist pressures and open up its markets more fully and consistently to exports by Brazil and other developing nations. No scheme for the repayment of Third World debts can be viable unless it provides a means for these countries to earn foreign exchange through increased exports. Brazil has achieved a substantial trade surplus since 1983 mainly by cutting imports to an unsustainably low level, by taking advantage of the strong dollar to expand exports to the United States, and at times by excessive export subsidies. If Brazil's productivity is to remain high and growth is to be resumed, imports of capital goods will have to rise again in future years. For that to happen, however, Brazil's exports must continue to expand.

Brazil has amply demonstrated its dynamism, ingenuity and productivity by winning increased export markets in many different products, including agricultural ones (soybeans, orange juice concentrate, sugar, and frozen poultry), footwear, textiles,

light manufactures, automobiles and auto parts, steel and various specialized products such as commuter aircraft and weapons. The United States and other OECD countries, however, have increasingly imposed various kinds of market restrictions whenever Brazil or another exporter shows a competitive advantage. It is vital for Brazil's national development that this protectionist tendency be reversed.

A U.S. economic policy that responds to the need of advanced developing countries for debt relief and expanded market access would enhance Brazil's economic strength and improve the prospects of U.S. investors, banks and exporters. It would greatly strengthen Brazil's renewed democratic political stability and would thus support the emergence of a regional climate for the protection of human rights. It would reward Brazil for its generally cautious and pragmatic policies to date and would thus reinforce them. It would also strengthen the position of moderate policymakers in Brazil, and would undermine the potential appeal of extreme nationalism that might take Brazil on a destructively autarchic course. The United States would also be in a much stronger position then to persuade Brazil to fight its own protectionist tendencies and to open itself more fully to world trade and to U.S. exports in particular.

If the United States and Brazil could help resolve the hemispheric crisis of debt and trade, they could build on other important mutual interests. Each country wants to find safe and reliable sources of energy. Each wants to protect and develop natural resources without doing ecological damage. Each wants to make international organizations and institutions more effective and to strengthen regional mechanisms for conflict resolution. Each also wants to prevent threats to hemispheric security by limiting Soviet involvement in the region.

Within each of these shared interests, elements of conflict also exist. These have become more evident in recent years as Washington and Brasilia have begun to clash over energy, ecology and policy toward the Middle East, Africa, and, to a limited extent, Central America. If economic relations between Brazil and the United States deteriorate in the coming period, such

differences would become much more contentious. Brazil could eventually become a formidable obstacle to the achievement of the international objectives of the United States.

Within the context of positive cooperation to resolve the hemisphere's economic crisis, however, Washington could instead regain in Brazil an important and effective international partner. Achieving and maintaining that partnership should be a major aim of U.S. policy. Brazil is still, fundamentally, a natural ally of the United States, but improved cooperation will only be possible if Washington recognizes that Brazil's needs require understanding and policy adjustments by the United States.

# Talking It Over

*A Note for Students and Discussion Groups*

This issue of the HEADLINE SERIES, like its predecessors, is published for every serious reader, specialized or not, who takes an interest in the subject. Many of our readers will be in classrooms, seminars or community discussion groups. Particularly with them in mind, we present below some discussion questions—suggested as a starting point only—and references for further reading.

## Discussion Questions

Brazil experienced rapid economic growth in the late 1960s and early 1970s. How important were government policies in promoting this "economic miracle"? What were the short-run costs of the miracle? the long-run costs?

Brazil has been ruled, off and on, by authoritarian military governments. Do you think that authoritarian governments are in a better position than democratic regimes to promote development? Is there a necessary tradeoff between civil liberties and socioeconomic reform? What has been Brazil's experience?

The gradual restoration of democratic politics and public participation—abertura—which began in 1974, led to the selection in 1985 of a civilian president, José Sarney, for the first time since 1964. Do you think the Sarney government will have the authority to carry out harsh economic austerity measures if inflation recurs? Is the military likely to step in to maintain order if the economic situation deteriorates once again?

Brazil subsidizes exports and protects its markets, and at the same time complains about U.S. protectionism. Should the United States open its markets to cheaper imports in order to help Brazil and other Third World countries, or should it erect barriers in order to protect declining U.S. industries? Is it in the

interest of the United States to keep its markets open? Should it pressure Brazil to accept more U.S. exports?

Compare and contrast the "moderate nationalist" and "moderate internationalist" approaches to development in Brazil. What are their implications for Brazil, and for U.S.-Brazil relations?

How and why did Brazil accumulate such a large debt? What role, if any, should the United States play in resolving the problem of Third World indebtedness? Why?

Do you agree with the author that more conflict, not less, will characterize U.S.-Brazil relations in the future? How should the United States respond to such conflict as does arise?

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